TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 947

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, PETITIONER

vs.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 12, 1942

CERTIORARI GRANTED MARCH 16, 1942

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A In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, PLAINTIFFS

vs.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, DEFENDANT

Stipulation of facts

Filed Dec. 17, 1940

It is hereby agreed and stipulated by and between the parties hereto, by their respective counsel, that the above-entitled cause shall be submitted to the Court for its decision on the following facts:

In November 1938, the Commissioner of Internal Revenue assessed the Plaintiffs the following deficiency income taxes for the calendar years 1936 and 1937:

1936		1937	
Tax	$3,399.71	Tax	$646.24
Interest	327.44	Interest	23.46
Total	3,727.15	Total	669.70

These amounts were paid by the Plaintiffs, on November 21, 1938, under protest. Later and prior to the filing of the amended complaint, appropriate claims for refund of the parts thereof hereinafter mentioned were filed with and denied by the Commissioner.

Included in the 1936 deficiency assessment is $200.68, and interest $19.33, which represents the amount the Plaintiffs were compelled to pay by reason of the disallowance of deduc-

B tions for the taxpayers' proportionate share of the 1936 City and State taxes paid by the Plaintiffs on certain real estate acquired by them during that year, and which amount they had deducted from their 1936 income tax return.

Similarly, included in the 1937 deficiency assessment is $640.26, and interest $23.24, which represents the amount the Plaintiffs were compelled to pay by reason of the disallowance of deduction for the taxpayers' proportionate share of 1937 City and State taxes paid by the Plaintiffs on certain real estate acquired by them during that year, and which amount they had deducted from their 1937 income tax return.

It is further agreed and stipulated that the seller of the properties involved herein only claimed deductions in its income tax return for State and City taxes proportionate to the date of sale.

It is further agreed and stipulated that all errors in pleading are waived and that the Court, in the event it shall hold that all the said deductions were properly allowable to the Plaintiffs by the Commissioner, shall enter judgment for the Plaintiffs against the Defendant for the sum of $883.51, with interest thereon from November 22, 1938, as provided by law.

It is further stipulated by counsel on both sides that they each reserve the right to produce additional testimony, should they deem the same advisable, at the hearing of this cause, not inconsistent herewith.

NATHAN J. FELSENBERG,
Attorney for Plaintiffs,
BERNARD J. FLYNN,
United States Attorney,
Attorney for Defendant.

1 *Appendix to appellant's brief*

In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, PLAINTIFFS

v.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, DEFENDANT

Judgment

1 Filed Feb. 3, 1941

This cause having duly come on for hearing before the Court, without a jury, and having been submitted for decision and judgment on the pleadings and the evidence, and the Court having heard arguments of attorneys for the respective parties, and having duly considered the briefs filed by them, and having duly considered the pleadings and evidence, and having filed herein its combined written opinion, findings of fact, and conclusions of law,

It is now ordered, adjudged, and decreed that the plaintiffs, Frederick M. Supplee and Elizabeth G. Supplee, do hereby re-

cover from the defendant the sum of $793.45, together with interest thereon from November 22, 1938, as provided by Section 177 of the Judicial Code as amended, as amended by Section 615 (b) of the Revenue Act of 1928 (45 Stat. 877; U. S. C., Title 28, Section 284).

And further, the Court certifies that the defendant acted in his official capacity in collecting the money herein recovered, and there was probable cause for his action.

2 And further, that in accordance with the provisions of Section 989 of the United States Revised Statutes (U. S. C., Title 28, Section 842), the amount so recovered, shall upon final judgment be provided for and paid out of the proper appropriation from the Treasury.

(s) W. CALVIN CHESNUT,
United States District Judge.

FEBRUARY 3, 1941.

In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE, AND ELIZABETH G. SUPPLEE, PLAINTIFFS

v.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE OF THE STATE OF MARYLAND, DEFENDANT

Opinion

CHESNUT, D. J.:

This personal federal income tax case involves a comparatively small sum of money, but is of particular practical interest to dealers in real estate. The question involved is whether a purchaser of real estate, who has adjusted the taxes on the property pursuant to the contract of sale, and afterwards pays the whole year's taxes, can properly deduct in his federal income tax return for the year the proportion of the taxes for that year which

3 was allocated to him in the adjustment. It probably will be a surprise to many dealers in real estate to learn that it is the Government's contention that the purchaser may not so deduct his proportion of the taxes, but must capitalize the amount assumed and paid by him as a part of the cost of the purchase. In this case the Commissioner of Internal Revenue disallowed the deductions, the taxpayers paid the deficiency taxes, and after denial of petition for refund, have sued to recover the alleged overpayments. The taxpayers kept their accounts on a cash, and not an accrual basis.

The plaintiff taxpayers in this case, Frederick M. Supplee and his wife, in 1936, and again in 1937, purchased several small apartment houses, in pursuance of what appears to have been a substantial business by them in real estate in Baltimore City, as they own numerous properties of this general class which they hold, operate, and manage for a profit. In the case of the several properties which they bought in 1936 and 1937, the taxes and other expenses on the property were adjusted between the seller and the purchasers in accordance with the contract of sale; and thereafter Mr. Supplee paid to the City Collector of Baltimore the full amount of the tax bills on the properties in and for the respective years in which they were purchased. In their income tax returns for these years they deducted from gross income the proportion of taxes allocated to them in the adjustments made at the time of the transfers, but did not include in the amount of the deductions the portion of the tax bill which in the adjustments was allocated to the vendors. It further appears that the latter in their income-tax returns deducted only the proportion of the taxes for the year which had been allocated to them in the adjustments.

It will be sufficient to give the details of one transaction which is typical of all. Sometime prior to May 10, 1936, the taxpayers entered into an agreement, in customary form in Baltimore City, to buy the apartment property known as 2325-2333 Reisterstown Road for $25,000. The contract provided for the adjustment of taxes and other expenses on the property. On May 10, 1936, the transaction was settled and on the settlement sheet the pur-
4 chasers were credited with the proportion of the taxes, both City and State, for the whole year of 1936 on the property which had accrued up to May 10th; and thereafter in due course Mr. Supplee paid the tax bills of the property for the whole year. In the settlement, other expenses on the property, including ground rent and water rent, were also adjusted by the seller and buyer. In preparing Mr. Supplee's income tax returns his bookkeeper inadvertently and erroneously failed to make proper distinction between adjustment of taxes and other items, and in one case seems to have inadvertently included among taxes deducted a portion or all of the amount allocated to the seller; but these mistakes have now been corrected, and to simplify the accounting problem it will be sufficient to state that it is the uncontradicted testimony in the case that, (1) apart from the question as to the deduction of proportioned taxes, the taxpayers have overpaid their taxes for 1936 and 1937 in the aggregate amount of $145.02, by reason of the failure to include among proper deductions various items of ground rent, water rent, and other

adjustments which constituted properly deductible "expenses"; and (2) if the taxpayers are also entitled to deduct their allocated portion of the adjusted taxes for two years then they are entitled to recover as overpayment the total sum of $793.45 with interest from November 22, 1938. In this respect the testimony has corrected the somewhat higher figure included in a stipulation previously filed in the case.

The applicable statutory provision is Section 23 of the Revenue Act of 1936 (see U. S. C. A., Title 26, Internal Revenue Acts 1924 to date, page 827), which provides, as far as applicable, as follows:

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

"(c) Taxes Generally.—Taxes paid or accrued within the taxable year, except" (the exceptions are not relevant in this case).

Similarly worded provisions were contained in prior and subsequent Revenue Acts.

If the statute had not specifically provided for deductions of taxes paid, it would seem reasonably clear that the taxpayers in this case would have been entitled to deduct the taxes allocated to and paid by them as an ordinary and necessary expense in carrying on their real estate business, just as they were clearly entitled to deduct the payment of ground rents, water rents and other necessary expenses on the properties, the income from which they of course had to include in their gross income. It is the uncontradicted testimony in this case that by reason of failure to properly itemize certain deductions of ground rent and water rent and possibly other items of expenses, the taxpayers have overpaid their taxes in the amount of $145.02 plus interest. I do not understand that any technical objection with respect to the procedure for refund was made by the defendant in this case to the recovery of at least that much by the taxpayers. However, it is argued for the defendant Collector that, as taxes have been specifically provided for in the statute, the question of their deductibility under the facts of this case must be justified if at all by the particular phraseology of the statute with respect to tax deductions. The language of this is exceedingly clear and simple. It permits the taxpayer to deduct "taxes paid or accrued within the taxable year." It is said for the defendant that the alternative of "paid or accrued" has reference to the alternative conditions, whether the taxpayer's return is on a cash or accrual basis; if on the cash basis then taxes paid are deductible; and if on accrual basis then taxes accrued are deductible. (See

U. S. v. Anderson, 269 U. S. 422; Comr. v. Coward, 3 Cir., 110 F. (2d) 725, 727.) It is also perfectly clear that the taxpayers in this case bring themselves precisely within the literal language of the statute in that they did pay the taxes within the taxable year. It is, however, the contention of the defendant Collector that the phrase "taxes paid" must be construed as if it read "taxes paid if assessed on the tax rolls to the taxpayer"; and that as so construed the taxpayers in this case are not entitled to the deduction, even though they ask only for the deduction of that portion of the taxes for the whole year which
6 accrued during their ownership of the property, and which of course they had to pay to continue in enjoyment of the property. As I understand it, the position of the defendant is that the taxpayer is not entitled to deduct taxes paid by him by reason of his ownership of the property unless he is personally liable to the taxing authority for the tax bill, irrespective of the lien of the taxes on his property. It is the defendant's further position that instead of the owner's deducing the amount of the taxes from his income he must capitalize the taxes so paid as a part of the cost price of the property.

Before beginning the discussion of the point of law thus raised, it is desirable to first refer to the legal incidents of the Maryland taxing system and the customary handling of real estate transactions in Baltimore City. I am referring to these not as necessarily controlling the determination of the particular question, but as a factor to be considered in connection with the defendant's construction of the federal statute. In Maryland taxes on real estate (but not on personal property) become a lien upon the property when due and so continue until paid; (Flack's 1939 Md. Code, Art. 81, S. 72); and are also apparently a personal liability of the owner in whose name the property is assessed on the tax rolls on the date of "finality." Md. Code Art. 81, S. S. 2 (20) and 154; Bassett v. Ocean City, 118 Md. 114, 119; Free v. Greene, 175 Md. 36, 41; Mayor and City Council of Baltimore v. Perrin, Md. Ct. of Appeals, April 4, 1940, Baltimore Daily Record, April 13, 1940. The taxes with which we are here dealing are those imposed on real estate by the State of Maryland, and also those separately imposed under the statutes by Baltimore City. Both classes of taxes become due and payable on January 1st of each year for that current year, although the City taxes are not in default for nonpayment until July 1st (after which time if not paid interest and penalties at a prescribed rate accrue thereon), and the State taxes become in default if not paid by January 1st of the succeeding year. (Md. Code Art. 81, S. 74.) It is also to be noted that in Baltimore City the "date of finality" with respect to City taxes is October 1st in

the year prior to the taxable year. The person who owns the property on October 1st and is assessed for it on the
7 assessment rolls thereby becomes liable for the taxes for the succeeding calendar year, even though he may sell and dispose of the property between October 1st and January 1st, when the taxes first become actually payable. In re Wells, 4 F. S. 329 (D. C. Md.). It is also to be noted, as appears from the uncontradicted testimony in this case, that it is the almost universal custom in Baltimore City, and has been for many years, that as between seller and buyer of real estate, taxes are adjusted to the date of settlement and transfer of the property. That is to say, if the settlement date is July 1st the seller is charged with one-half of the tax bill for the whole calendar year and the buyer with the other half, and so proportionately with respect to settlement at any other date during the calendar year. If the taxes have not been paid by the seller prior to the settlement date the purchaser assumes the whole tax bill and is credited with that proportion of the year's taxes which has accrued up to the date of settlement. If the seller has already paid the taxes for the year he is credited with that proportion of the taxes allocated to the purchaser. It also appears from the testimony in this case of two experienced certified public accountants that for many years past, in preparing income tax returns for their clients, they have habitually deducted taxes as adjusted between seller and buyer as was done in this particular case by the taxpayers.

Counsel for the defendant Collector contends in this case that the taxes as adjusted and paid by the taxpayers were not deductible because (1) the taxes became a lien on the property in the hands of the former owner, and (2) there was no personal liability on the taxpayers for any part of the taxes for the year directly to the local taxing governments. In support of this position reference is made to Treasury regulation 94, promulgated under the Revenue Act of 1936, Article 34 (C)-1 which provides that in general taxes are deductible only by the person upon whom they are imposed; and to certain decisions by the Board of Tax Appeals and in the 6th and 8th Circuits which, in general terms, state that taxes assessed and constituting a lien on real estate before a sale may not be deducted
8 when paid thereafter by a purchaser, but must be treated as a part of the cost of the property. Illustrative cases are California San. Co. v. Comr., 32 B. T. A. 122; Merchants Bank Bldg. Co. v. Helvering, 8 Cir., 84 F. (2d) 478; Lifson v. Comr., 8 Cir., 98 F. (2d) 508; Walsh-McGuire Co. v. Comr., 6 Cir., 97 F. (2d) 983. Thus it is succinctly stated in the Lifson case, page 510, as follows:

When one purchases land which is subject to a lien for taxes, the subsequent payment of those taxes by the purchaser does not constitute an allowable deduction from gross income, for the reason that the taxes accrued while the land was in other ownership and the payment of them is merely a payment of a part of the cost of acquiring the property."

But it will be found on examination that these cases (with one exception noted) have not dealt with the deduction of taxes adjusted for a current tax year, which is the problem here presented. It is clear enough that unpaid taxes for a prior year, which are properly a charge against income for that year, wholly preceding the new ownership, must be treated as a part of the cost, and (as is almost universally the case in Baltimore City) are credited to the purchaser on the settlement sheet at the time of the transfer of the property. We are dealing here only with taxes for a current year as allocated to the seller in proportion to the period of the year for which he has the ownership. In a similar case the adjusted taxes were allowed to the purchaser as a deduction for the current year in John Hancock Mutual Life Ins. Co. v. Comr., 10 B. T. A. 736; and see Helvering v. Missouri State Life Ins. Co., 8 Cir., 78 F. (2d) 778, 781; and Comr. v. Coward, 3 Cir., 110 F. (2d) 725. But more importantly for the instant case, the Circuit Court of Appeals for this fourth circuit has very recently decided a case, which on the facts is quite similar to the present case, and the reasoning of which I think supports the view that the taxpayers in this case were entitled to the deductions for taxes paid. Comr. v. Rust, 4 Cir., Dec. 18, 1940. The case is of course imperative authority here to the extent that it is applicable.

In the Rust case the taxpayer bought real estate in Washington, D. C., on September 17, 1935, the fiscal tax year being July 1st to June 30th, with tax payments due semiannually in September and March. The taxes for the fiscal year were adjusted to the date of transfer of the property between the vendor and the taxpayer purchaser in accordance with the contract of sale. The taxpayer deducted the proportion of the taxes paid by him in March 1936 in his federal income tax return for that year. This was disallowed by the Commissioner, but sustained by the Board of Tax Appeals, and affirmed on appeal to the fourth circuit, Judge Soper writing the opinion (Judge Parker dissenting). If the Rust case is distinguishable at all from the present case, the distinction lies only in the difference between the Maryland taxing system and that of the District of Columbia. The differences so far as applicable to this case are (1) although the taxes in Washington are assessed prior to the beginning of the fiscal year they

do not become a lien until they are in arrears and proceedings are taken to enforce payment; (2) the owner of real estate is apparently not personally liable for the taxes but only the property itself; and (3) the taxes are payable in semi-annual installments and only the second installment due in March 1936 was involved in the Rust case. The contention of the Commissioner there, as in this case, was that, as the taxes had been assessed to the prior owner of the property, the purchaser was not entitled to deduct his allocated proportion thereof for the current fiscal year but was obliged to capitalize the amount as a part of the cost price. This contention was definitely rejected by the court, Judge Soper saying with respect thereto in the opinion:

"But this theory is not in accord with the actualities of the ordinary case * * * Furthermore, the Commissioner's theory does violence to the purpose of the income tax statutes that items of income shall be accounted for in annual periods. Clearly this purpose will not be served if the constantly recurring burden of the tax is refused recognition as an item of current expense and is placed in the category of a capital expense to be reckoned with under the income tax statutes only in the event of sale at some future date."

Again it was said in the opinion:

"Taxes upon real estate, constitute an ever recurring burden; and when, as in this case, the property is held as an investment, they are perforce treated as a current expense to be offset against current income. The provision of the agreement of sale that the taxes should be adjusted to the date of sale was therefore natural and proper, since it allotted to each party a part of the burden proportionate to the period during which he possessed the property and enjoyed the income. Such an arrangement between buyer and seller is typical, and it would be in accord with the facts even if prior to the sale the tax has not only been assessed but has given rise to a lien. The apportionment of the tax was clearly correct in the transaction under discussion, since no part of the second installment of the tax could be fairly allotted to the seller and no part of it was collectible by the District during his period of ownership. The burden of paying this installment was an obligation which passed to the taxpayer with the ownership, in much the same fashion that the benefit of certain covenants is held to run with the land in the law of property; and the burden of the tax rested upon the taxpayer in a very real sense, for a delinquency would have been followed by a forced sale by the tax authorities."

The opinion in the Rust case also discusses and summarizes the prior cases above referred to, points out certain differences

between the case under consideration and the prior cases and concludes:

"Whether this attitude should not also be taken in the event of a sale after personal liability on the part of the seller or a statutory lien for the tax has arisen, we have no occasion to decide. The question here is whether, in the absence of personal liability and of a lien, the parties may agree to apportion a tax, not yet payable, to their respective periods of ownership. We think that they may; because such an agreement merely assigns to each party the obligation to bear his own burden of taxation."

11 It is therefore true that the Rust case is not an expressly controlling authority for the instant case, because the Maryland statutory scheme of taxation differs technically at least from that in the District of Columbia; but a careful reading of the opinion leads me to the conclusion that the reasoning and principle of decision should control this case in favor of the taxpayer.

As pointed out in the Rust case, taxes are an annually recurrent burden on real estate, whether a lien or not. In this respect they are not different from ground rents, water rents, and other fixed charges on property. To the extent that they are current they are properly chargeable to maintenance and not to capital by proper accounting practice. They are necessarily a charge against income and not an addition to capital. On the other hand, unpaid taxes for prior years are not properly chargeable to current income for a subsequent year, and, on a change of ownership of property, necessarily constitute a part of the cost of the property. The statutory provision for the deduction of taxes should be applied in the light of the subject matter. The federal income tax is a tax on net and not on gross income; and the accounting with the government is put on an annual basis. The general purpose of the income tax is to find and tax the true net income as defined in the statute. This is accomplished only when current taxes and similar items are deducted from the current income. When an income taxpayer purchases investment property he is chargeable only with the income subsequently accruing from the property, and current charges against it are properly deductible to ascertain the net income. If the current income is adjusted to the date of transfer, similarly the current charges against the income should be likewise adjusted.

The federal income-tax statute allows deduction for taxes paid or accrued during the taxable year. The wording is plain and simple and, in the context of the whole statute, seems to clearly mean that the current tax burden on property is to be deducted from current income from the property. In specifically men-

tioning taxes, in addition to current expenses, Congress probably had in mind the fact that expenses generally are deductible only with respect to a business, while taxes may also be deducted if paid on property owned for personal needs or pleasure,
12 as in the case of a dwelling. It is true, as provided in the applicable Treasury regulation (T. R. 94, Art. 34 (C)–1) that in general taxes are deductible only by the person upon whom they are imposed, and this is normally the case. Obviously a gratuitous payment of some other person's taxes would not be deductible by an income taxpayer. But if the relationship of the taxpayer to the property is such that he must, as a practical matter, pay the tax to continue in the enjoyment of the income or use of the property, the statute is gratified because the payment is a necessary charge against the income if any from the property.

The statute does not condition the deductibility of the taxes paid on the ownership of the property at the time of the assessment for local taxes, or on the particularities of the varying statutory schemes in the several states; and to cut down the taxpayer's right to the deduction by reason of the technical requirements of local taxation seems to contravene the plain words of the federal statute. It also introduces an unnecessary and undesirable lack of uniformity in the administration of the federal statute in the several states. Nor does it necessarily benefit the federal revenue, because, if the purchaser of property must capitalize the current taxes, his profit is less, or loss greater, when he resells, and his taxable income is thus diminished.

It is said for the defendant that in this case the taxpayers have paid the seller's taxes. But this is not so in reality. True the seller remained primarily liable to the local government, but, with respect to the property itself, the purchaser had the direct liability to pay the taxes to save it from tax sale; and legally the purchaser was directly liable to the seller to pay the taxes for the current year which he had assumed in the adjustment. We must bear in mind that we are applying the federal statute, and the accounting is between the taxpayers and the federal government with respect to what is the net income of the taxpayers. The details of the local tax statutes do not control the matter except insofar as they necessarily affect the determination of the net income. That the property was subject to a lien for taxes shows that the purchaser who had assumed the taxes was really the person obliged to pay them to avoid the loss of the
13 property, and in paying them he discharged his own obligation, rather than that of another. In accounting with the federal government, it is immaterial that, with respect to the local taxing authority, the seller was primarily liable, and the

purchaser liable over to the seller. The ultimate legal liability for the taxes was clearly on the purchasers in this case; and as they necessarily sustained the burden of the tax payments, there is no reason to deny them the deduction in their income-tax accounting with the federal government. It thus becomes clear that the mere fact that the seller was the owner of the property at the time the local tax assessment was made, and therefore the debtor to the local government, as the named owner on the tax rolls, is legally immaterial in the federal tax problem.

I conclude that the plaintiffs are entitled to recover for overpayment of taxes in 1936 and 1937 the sum of $793.45 with interest. Counsel may submit the appropriate order for judgment, with provision for interest in accordance with the specially applicable statute. I assume this opinion will be a sufficient finding of facts and conclusions of law, but if more is desired, they can be submitted for consideration.

(s) W. CALVIN CHESNUT,
United States District Judge.

JANUARY 22, 1941.

14 *Plaintiff's exhibit one*

(Settlement Sheet—12/17/40)

TITLE GUARANTEE AND TRUST COMPANY

MEMORANDUM OF SETTLEMENT

App. No. 76436.

Sale made by Royal Realty Corp to Frank H. Creese & Co.

Property 2325-2327 Reisterstown Rd.
Adjustment made to May 10th, 1936.

Credit to Seller:		
Amount of Purchase Price		$25,000.00
Total Credit to Seller		$25,000.00
Deduct:		
Cash paid on account	$200.00	
Rent allowances less stove adjustment	84.80	
1936 Taxes (Current Year) 4⅓ months	398.67	
Allowance	25.86	
Mortgages and interest thereon to Vendors	20,000.00	
Sundries:		
Revenue Stamps in full	25.00	
Total Deductions	20,734.33	20,734.33
Balance Due		$4,265.67

Received of Frank H. Creese & Co., Inc., the sum of $4,265.67 Dollars being in full settlement of the above transaction.

It is agreed that any error or omission in the above settlement will be corrected by the parties hereto.

Dated May 12th, 1936.

JOHN E. WEYER.

15 *Appendix to appellees' brief*

TESTIMONY (pp. 17–20) OF HARRY E. KARR

Direct examination by Mr. FELSENBERG:

Q. Your full name is Mr. Harry Karr?—A. Harry E. Karr.

Q. You are a member of the local Bar?—A. I am.

Q. I believe you are also engaged in the real estate business?—A. Yes.

Q. Have you handled real estate transactions during the course of your practice of law?—A. I have put through a right good many, probably four or five thousand.

Q. How long have you been a member of the Bar?—A. Forty-two years.

Q. And you are still in active practice?—A. I am glad to say I am.

Q. Now, Mr. Karr, in the many years of your practice in putting through settlements, what do you find to be the general custom and usage in real estate transactions with respect to the adjustment of expenses, particularly taxes as between vendor and vendee at the time of sale?—A. Well, for many years the Daily Record Company have been printing contract forms for sale of real estate. Most of those forms have in the body of them, all have in the body of them taxes, ground rent, insurance, to be adjusted to such and such a date. Practically, I would say 95 percent of the contracts that come through when the matter of settlement is being made for the properties, usually has in the contract "adjustments made to date of transfer." That means that when settlement is made, in some instances the seller who would be prompt in the payment of his taxes, and wants to take his full adjustment, he has paid his taxes at the beginning of the year, as soon as the bill is rendered,

16 and in that event the adjustment is made by the buyer paying back to him the number of days which have been paid in advance. Of course, there are a great many cases where the seller has not paid his taxes and the reverse takes place. Making up the settlement sheet the seller allows credit on account of the purchase for the number of days for taxes which he should have paid.

Q. Now, Mr. Karr, this form of the Daily Record that you refer to, that has been more or less the adopted form that is generally used in the real estate trade?—A. A great many real estate offices have made up their own forms and had them printed, and some of them have something more elaborate. Of course, if you would go into any of the stationery stores to buy forms of contract to buy and sell real estate you would get a form substantially as I have said.

Q. Substantially the form of the Daily Record?—A. Yes.

TESTIMONY (pp. 48-9) OF ALLEN G. BASS.

Direct examination by the COURT:

Q. And you say the quite uniform practice up to two or three years ago was for taxpayers to make deductions in the case of purchases of property and adjustment of taxes for a particular year?—A. I can not speak for anyone else, but for the tax returns I prepared I did allocate the expenses and income.

Q. Over what period of years, from 1913 on?—A. I have been in the tax practice before 1913.

Q. You have been doing it right along for your clients?—A. Yes, sir.

Q. Have you ever known of any rejection of such deductions?—A. I have never had one on one of the returns I prepared, but as stated, there have been a very large number of such cases that have come up in other jurisdictions recently.

17 Q. I understand that. I am asking you about the uniform practice as far as you know it up until 1938.—A. I can say to the extent of my practice and of my organization in preparing returns we uniformly pro rate interest and taxes.

Q. Ernst & Ernst are accountants having main offices where, New York or Cleveland?—A. Cleveland is the home of our managing department.

Q. Where do they have branch offices, in how many cities?—A. I think we have forty-six.

Q. Throughout the United States?—A. Yes, sir.

TESTIMONY (pp. 56-8) OF LOUIS J. JIRA

Direct examination by Mr. FELSENBERG:

Q. You are a member of the Baltimore Bar?—A. Yes, sir.

Q. You are also connected with the Maryland Title & Guarantee Company?—A. That is right, vice president.

Q. You have been practicing law for how many years?—A. Since 1912.

Q. I believe you more or less specialize in the field of real property?—A. That is correct.

Q. During the period of years you have been practicing law, you have had occasion to put through many settlements of real estate between buyer and seller, have you not?—A. That is correct.

Q. In your experience you have seen many contracts drawn between the buyer and seller, have you not?—A. Yes, sir; I have.

Q. Now, in Baltimore City particularly, what do you find to be the custom, usage, and practice with respect to adjustment
18 of state and city taxes between vendor and vendee?—A. To the date of settlement as fixed by the terms of the contract.

Q. What does the usual contract provide, or the adopted practice with respect to the contract provide?—A. It usually provides that taxes shall be adjusted between vendor and vendee of a particular date—taxes due and unpaid and taxes which have been paid, both ways.

TESTIMONY (PP. 62–65) OF HOWARD A. SCHNEPFE

Direct examination by Mr. FELSENBERG:

Q. Mr. Schnepfe, what is your profession?—A. I am a certified accountant.

Q. You have offices in Baltimore City?—A. Yes, sir.

Q. Where is your office?—A. Baltimore Trust Bldg.

Q. How long have you been a certified public accountant?—A. I think I received my certificate in 1925.

Q. And you have been in active practice ever since?—A. I was in practice before, since 1918.

Q. During your practice as a certified public accountant, have you had occasion to make out income-tax reports for various people?—A. Yes.

Q. Have you had occasion to make out income-tax reports for people who had purchased certain real estate with respect to the adjustment of taxes and so forth?—A. Quite frequently.

Q. What has been the established practice with respect to the deduction of taxes for income-tax purposes in the report to the Federal government, so far as you know?—A. Our practice has been to prorate the taxes.

By Mr. FELSENBERG:

Q. Between whom?—A. The purchaser and seller.

Q. And in filing the report with the Internal Revenue Collector, how much of that portion would charge off
19 insofar as the purchaser was concerned?—A. It would depend on when the agreement was entered into, the date of settlement.

Q. Let me give you this specifically: Suppose a purchaser purchases a piece of property on March 1 of a given year and he paid the taxes himself from March 1st until December 31st of that year. That would be ten months. In filing the income-tax report what was your policy with respect to deductions? How much would you take off?—A. The purchaser would take off 10/12. The seller would take off the remaining.

Q. That is between the seller and buyer?—A. Yes, sir.

Q. How about the buyer when he makes out his income-tax report? how much will he deduct from his income tax?—A. He would deduct his pro rata proportion, it would be 10/12.

Q. And that has been your established practice?—A. That has been our practice.

By the COURT:

Q. Have you continued that practice up to today?—A. Yes, sir. We are doing that because of the fact that we think that is the proper way as far as accounting is concerned.

Q. What have you to say to the suggestion that in a situation like that the purchaser ought not to take the deduction for his proportion of the year's taxes, but to capitalize that tax adjustment into his purchase price.—A. Well, we use the basis of the contract as the purchase price in establishing whether there is a profit or loss. We feel as though the tax attaches as of January 1st and is paid in advance, that the tax follows the property, and we feel regardless of who owns it there is a certain deduction for the particular length of time that person owns the property.

20 TESTIMONY (PP. 66–69) OF MELVIN E. DIFFENBAUGH

Direct examination by Mr. FELSENBERG:

Q. Mr. Diffenbaugh, what is your profession?—A. Assistant Auditor of Union Trust Company.

Q. How long have you been connected with the Union Trust Company?—A. Twelve years.

Q. Are you familiar with the transactions in which Mr. Supplee and the company that you are employed by had sold certain properties and purchased by Mr. Supplee?—A. The Royal Realty Corporation.

Q. Are you familiar with that transaction?—A. Yes.

Q. The Royal Realty Company is a certain subsidiary, I believe, of the Union Trust Company.—A. That is right.

Q. And so you are familiar with the transactions?—A. Yes.

Q. What is that sheet you have there?—A. That is 2325 to 33 Reisterstown Road, original ledger sheet. On April 21, 1936, a deposit of $200 was made on the purchase, the purchase price being,

$25,000. On May 12, 1936, the settlement was made at which time the tax bill was turned over to the purchaser the amount being $1,143.99. He was allowed an adjustment of $398.67 from January 1 to May 12, so that the Royal Realty Corporation's expense for that year amounted to $398.67, and the purchaser's expense $745.32.

Q. I direct your attention particularly to your own taxes that you were charged with in this settlement, and ask you whether if that particular property was sold on May 12th of that year and your firm paid a proportionate amount of taxes from January 1 until May 10, 1936, for how much of that tax did you ask an allowance in your income-tax return, if you filed one? First, did you file an income-tax return for your firm?—A. Yes.

21 Q. How much tax allowance did you claim, talking about it proportionately now? Did you claim for the entire year or claim only for the proportionate year from January 1 to May 12?—A. From January 1 to May 12.

Q. And it was the same type of allowance that you claimed in all your other properties that Mr. Supplee purchased?—A. The same nature.

By the COURT:

Q. I did not quite understand whether what you are telling me was knowledge coming from your position as treasurer or assistant auditor of the Union Trust, or whether your connection with the Royal Realty Corporation as separate and apart?—A. The Royal Realty Corporation is a subsidiary of The Union Trust, and it acquires this property—it is a holding company.

Q. And your practice has been to handle the tax deductions and income tax accounting in the same way Mr. Supplee did?—A. Yes, sir.

Q. How long have you been doing that, for how many years?—A. Since 1930.

Q. You have had numerous such transactions in each year?—A. Yes, sir.

Q. And you have made income tax returns every year?—A. Yes, sir.

Q. And never had any of them questioned or revised on account of the tax deduction you made?—A. No, sir.

G. C. M. 6667, VIII-35-4324

REVENUE ACT OF 1928

"The ownership of property in the State of Washington on March 1 is the 'event' which determines the liability for both real estate and personal property taxes and fixes the amount,

although not ascertainable on that date. (Recommended that I. T. 2377 (C. B. VI–2, 59) be revoked.)

22 "An opinion is requested relative to the accrual date of property taxes in the State of Washington.

"In General Counsel's Memorandum 6273 (C. B. VIII–1, 168), involving the accrual date of property taxes in the State of Illinois, it was held that under the laws of Illinois the ownership of property on April 1 is the 'event' which determines the liability for property taxes and fixes the amount, although not ascertainable on that date. (See also G. C. M. 6272, C. B. VIII–1, 170, involving the accrual date of property taxes in the State of Texas.)

"An analysis of the statutes of the State of Washington and certain court decisions thereunder leads to the conclusion that both real and personal taxes accrue on March 1. Section 11097 of Remington's Compiled Statutes of Washington, 1922, provides that all real and personal property shall be subject to assessment and taxation upon equalized valuations thereof, fixed with reference thereto on the 1st day of March, 12 o'clock meridian, in each and every year in which the same shall be listed.

"Section 11109 provides that all real property shall be listed and assessed biennially in every even-numbered year with reference to its value on the 1st day of March preceding the assessment, and that personal property shall be listed and assessed every year with reference to its value on the 1st day of March preceding the assessment; provided, further, that all real estate subject to taxation shall be listed by the assessor every year in the detailed and assessment list, and in each odd-numbered year the valuation of each tract for taxation shall be the same as the valuation as equalized by the county board of equalization in the preceding year.

"Section 11110 provides that the assessor shall complete the listing and placing of values on all real property by May 31 of each even-numbered year and on personal property annually.

23 "Section 11127 provides that the owner of personal property moving from one county to another between the 1st day of March and the 1st day of July shall be assessed in either in which he is first called upon by the assessor. The owner of personal property moving into the State from another State between the 1st day of March and the 1st day of July shall list the property owned by him on the 1st day of March of such year in the county in which he resides.

"Section 11137 requires owners or agents to file with the assessor a list of all personal property owned on March 1, 12 o'clock m.

"Provision is made for a board of equalization for the correction of errors, for the actual levy of the tax and its collection, the latter generally beginning in January of each year.

"Section 11272 provides that the taxes assessed upon real property shall be a lien thereon from and including the 1st day of March in the year in which they are levied until the same are paid. The taxes assessed upon personal property shall be a lien upon all the real and personal property of the person assessed from and after the date upon which such assessment is made.

"In Klickitat Warehouse Co. v. Klickitat County (42 Wash., 299, 84 Pac. 860) the Supreme Court of Washington held that the lien for taxes on personal property attaches to the personal property and real estate of the person assessed immediately when such property is listed with the county assessor, and he has placed his value thereon. This case was followed in city of Puyallup v. Lakin (45 Wash., 368, 88 Pac. 578), in which it was said that the word "assessment" as used in the law meant the valuation of property for taxation by the assessor and not the levy of taxes by the commissioners. It should be noted that these decisions did not mean that there was no liability for the taxes prior to the date the lien attached,
24 as is clearly indicated by the decision of the same court in Sloan Shipyards Corporation v. Thurston (111 Wash., 361, 190 Pac., 1015). In this case the plaintiff alleged that the property assessed to it was not its property, and that it did not own the property on the 1st day of March 1918, the date fixed by law as of which the property was required to be assessed. It appears that the plaintiff had filed with the assessor a list of personal property on March 11, 1918, and later contended that two of the four items listed were not owned by it on March 1, 1918; consequently, that it was not liable for the tax on those items. In denying the plaintiff's contention the court said:

"The rule in regard to the ownership of property for the purpose of taxation is stated in 37 Cyc., at p. 788, as follows:

" 'Ordinarily, and in the absence of statute to the contrary, property is taxable only to the person who is the owner thereof at the date for its listing or assessment, or the date fixed by statute as of which its ownership for purposes of taxation is to be determined; and taxes are not a lawful charge on property unless assessed in the name of its owner, and any attempt to enforce the payment of taxes assessed and charged to the wrong person will be ineffective. * * *

* * * * *

"* * * We are satisfied, therefore, that the trial court properly found that the appellant for the purpose of assessment was the owner of the property on the 1st day of March 1918, and is therefore liable for the whole tax.'

"In view of the Washington statutes and decisions cited, this office is of the opinion that the ownership of property in Washington on March 1 is the 'event' which determines the liability for both real estate and personal property taxes and fixes the amount, although not ascertainable on that date. (G. C. M. 6273, G. C. M. 6272, supra.) It is recommended that I. T. 2377 (C. B. VI-2), 59, holding that property taxes accrue upon delivery of the tax rolls or lists to the treasurer or collector of taxes be revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue."

TESTIMONY (p. 12) OF FREDERICK M. SUPPLEE

Direct examination by Mr. FELSENBERG:

Q. In filing your income tax return for these properties you also claim only that portion of the year in which you actually owned the property?—A. Yes, sir.

In United States Circuit Court of Appeals for the Fourth Circuit

No. 4825

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, APPELLANT

v.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, APPELLEES

Appeal from the District Court of the United States for the District of Maryland

Argument of cause

November 11, 1941 (November Term, 1941), cause came on to be heard before Parker, Soper, and Dobie, Circuit Judges, and was argued by counsel and submitted.

28 United States Circuit Court of Appeals, Fourth Circuit

No. 4825

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, APPELLANT

v.

FREDERICH M. SUPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, APPELLEES

Appeal from the District Court of United States for the District of Maryland, at Baltimore

(Argued November 11, 1941. Decided November 12, 1941)

Per Curiam opinion

Filed Nov. 12, 1941

Before PARKER, SOPER, and DOBIE, Circuit Judges.

Morton K. Rothschild, Special Assistant to the Attorney General (Samuel O. Clark, Jr., Assistant Attorney General; J. Louis Monarch and Michael H. Cardozo, IV, Special Assistants to the Attorney General; Bernard J. Flynn, U. S. Attorney, and T. Barton Harrington, Assistant U. S. Attorney, on brief) for Appellant, and Nathan J. Felsenberg (James M. Hoffa on brief) for Appellees.

PER CURIAM: The majority of the court are of opinion that the judgment appealed from should be affirmed on the opinion of the court below and on the authority of the decision of this court in Commissioner v. Rust's Estate, 4 Cir., 116 F. 2d 636. Judge Parker dissents on the ground that the taxes paid, being a lien on the land and a personal liability of the vendor at the time of the conveyance to the taxpayer, were not deductible by the latter from income, for the reasons set forth in the dissenting opinion in the Rust case.

Affirmed.

A true copy,

Teste:

_____, *Clerk,*

U. S. Circuit Court of Appeals, 4th Circuit.

29 In United States Circuit Court of Appeals

Judgment

Filed and entered November 12, 1941

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Maryland, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed with costs.

November 12, 1941.

JOHN G. PARKER,
U. S. Circuit Judge.

On another day, to wit, December 13, 1941, the mandate of this court, in this cause, is issued and transmitted to the District Court of the United States for the District of Maryland, at Baltimore, in due form.

Clerk's certificate

UNITED STATES OF AMERICA,
Fourth Circuit, ss:

I, Claude M. Dean, Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, do certify that the foregoing is a true copy of the appendix to the brief of the appellant, the appendix to the brief of the appellees, and the proceedings in said circuit court of appeals in the therein entitled cause, as the same remain upon the records and files of the said circuit court of appeals, and constitute and is a true transcript of the record and proceedings in the said circuit court of appeals in the said cause, made up in accordance with the direction of the Solicitor General of the United States, for use in the Supreme Court of the United States on an application for a writ of certiorari.

In testimony whereof I hereto set my hand and affix the seal of the said United States Circuit Court of Appeals for the Fourth Circuit, at Richmond, Virginia, this twenty-seventh day of January, A. D. 1942.

[SEAL]

CLAUDE M. DEAN,
Clerk U. S. Circuit Court of Appeals,
Fourth Circuit.

30 Supreme Court of the United States

Order allowing certiorari

Filed March 16, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

31 In the Supreme Court of the United States

Stipulation as to record filed March 30, 1942

Subject to this Court's approval, it is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that for the consideration of this case on the writ of certiorari to the Circuit Court of Appeals for the Fourth Circuit granted March 16, 1942, the printed record may consist of the following:

1. The material contained in the printed transcript of record (consisting of 30 pages) used for the purposes of the petition for writ of certiorari herein.

2. The stipulation of facts filed in the District Court and contained in the certified transcript of record before this Court in this proceeding, at pages 7–8.

3. This stipulation.

It is further agreed that in the briefs for either party reference may be made to any portion of the transcript of record which is not included in the printed record prepared as aforesaid.

CHARLES FAHY,
Charles Fahy,
Solicitor General of the United States,
Counsel for Petitioner.

NATHAN J. FELSENBERG,
Nathan J. Felsenberg,
Counsel for Respondents.

Dated this 20th day of March, 1942.

[File endorsement omitted.]

U. S. GOVERNMENT PRINTING OFFICE: 1942